

Investment in Equities: Sharī‘ah Appraisal of Screening Norms

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Abstract

Investment in equities is an important but controversial topic in the literature on Islāmic Finance. Keeping in view its need for both the investors and the companies, different Sharī‘ah Screening Criteria have been developed to determine legitimacy or illegitimacy of stocks of a particular company from the point of view of investment. These Screening Criteria use some Sharī‘ah maxims as the basis for tolerating various prohibited things up to a limit (mostly up to 33%) in case of mixed business activities. Scholars who are involved with the Islāmic finance industry accept these criteria keeping in view the need for existence of capital market for Islāmic financial institutions, but some other scholars challenge the validity of these screens and consider the use of Sharī‘ah maxims as improper. This paper aims to review and analyze the arguments of both the groups and to discuss the need to review the basis of screens or the extent to which these criteria could be used and where their use might not be as necessary as presently considered.

Keywords: Equities, Sharī‘ah Screens, Mixed Business Activities, *‘Umūm Balwa*, *Rafa‘ al-haraj*, Review of Screens.

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1. Introduction

Investment in equities is an important area of investment for individuals and financial institutions under present financial system. It provides an opportunity to financial institutions to get financial resources without involving in interest on one side, and to the individuals looking for interest free investment opportunity, on the other. Generally it is considered permissible to invest in stocks of a business company on the reason that it

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is an act of becoming partner in the business to share the actual returns of the business. Despite the general permissibility, there are certain Sharī'ah issues involved in stocks trading which warrant serious consideration by the Sharī'ah scholars:

- a) Is it allowed to purchase shares of a company which is involved in any impermissible business activity? Will it not be like becoming partner in an impermissible business?
- b) Under present financial system, each company arranges finance through debt as well as equity. In most cases debts are interest based. Is it allowed to become partner in a business in which interest based financing is involved?
- c) Each company has liquid as well as illiquid assets. What is the Sharī'ah position of purchasing shares of a company against cash when shares represent liquid assets beside physical assets?
- d) Normally each company has account receivables in total assets representing company's outstanding debt against other organizations or individuals. Is it allowed to sell/purchase the share of such a company in the secondary market at a price different from its face value?
- e) Each company invests its surplus funds in different investment avenues in order to earn some return on these funds. Shareholders receive income in the form of dividend, which contains some portion of impermissible income as well. Is it allowed to receive income containing some impermissible portion?

Strictly speaking, it is difficult to find a company free from all these issues. Hence, a committed Muslim investor finds it difficult to select equities which are fully Sharī'ah compliant. Keeping in view the need of investors and specially the Islāmic financial institutions, contemporary Sharī'ah scholars have addressed this issue and devised Sharī'ah screening criteria against which Islāmicity or otherwise of a stock could be judged. For a stock to be Sharī'ah compliant, they require that it must meet certain conditions like that the core business of company should be Halal or that the ratio of liquid assets to total assets should not exceed certain limit.

Presently investment in Islāmic capital market is governed by a number of screening norms and methods such as Dow Jones Islāmic Market Index criteria, FTSE criteria, Meezan's criteria for investment in stocks, AAOIFI's screening criteria and SEC Malaysia's screening criteria.

The common attribute in all these screens is the condition that the business activities of investee Company should be *ḥalāl*. Other filters such as debt ratio, liquid assets ratio, impermissible investment ratio and impermissible income ratio are disputed among Sharī'ah scholars, as well as the Islāmic financial institutions operating in the capital markets. As a result, a particular stock is treated as Sharī'ah-compliant and *ḥalāl* under one screen, whereas the same is considered unlawful and *ḥarām* under the other.

A considerable number of Sharī'ah scholars support these criteria, as they find their legitimacy in the Qur'ān, Sunnah and other sources of fiqh. While another group of scholars find some doubts about their Islāmīcity and view them as compromises on Sharī'ah prohibitions to allow the Islāmic Capital market to exist to cater the requirements of Islāmic Financial institutions. They may not be convinced with the justifications provided by the supporters of these screens.

The objective of this study is to examine the Sharī'ah legitimacy of these screening criteria, to critically evaluate the arguments of both the proponents and opponents of these filters and to suggest the way forward for healthy growth of Islāmic capital market.

2. Screening Norms for Sharī'ah Compliance

As pointed out earlier, the Sharī'ah scholars have laid down screening criteria for investment in shares and stocks. This criterion takes into account the following issues:

- Business activities of the investee company
- Debt to total assets ratio
- Liquid assets as a percentage of total assets.
- Investment in non-Sharī'ah compliant activities
- Income from non-Sharī'ah compliant activities
- Net liquid assets versus share price

These screening norms can be divided into two broad categories:

- i) Screens for business and activity of the company and;
- ii) Screens pertaining to financial ratios such as debt to total asset ratio and liquid to illiquid assets ratio, etc.

In the following, we will focus on these screens.

2.1 Screens or Acceptable Business of the investee company

An important criterion to judge whether a stock is Sharī'ah compliant or not, is the nature of business of enterprise. If the core business of investee company is lawful (*ḥalāl*), then it is included in the investable universe of Sharī'ah compliant equities. This implies that stocks of the companies which are engaged in unlawful (*ḥarām*) businesses are not eligible for investment in the capital market. Thus, investment in shares of conventional banks, insurance companies, leasing companies, pork-related products industry, alcohol industry, companies engaged in activities such as gambling, pornography, etc is not permissible.

The opinion of Sharī'ah scholars is, however, divided on the status of shares of a company whose core business is *ḥalāl*, but is involved in certain *ḥarām* activities as well; like interest based borrowing from conventional banks or holding some interest bearing securities or placing surplus funds in interest bearing bank accounts. It also includes companies involved partly in *ḥarām* activities such as hotels or airlines which may sell or serve alcoholic drinks as part of their operations though their main activity is to provide accommodation and transportation to its customers. The scholars have divergent positions on this issue. A group of scholars does not allow investment in such stock while the other allows it. These opinions and their arguments are discussed here:

3. View Point of Opponents

The scholars belonging to this group maintain that investment in the shares of companies which are partly involved in un-Islāmic activities is not permissible. *Fiqh* Council of World Muslim League, Makkah¹, International *Fiqh* Academy, Jaddah², Council of *Fatwā* and Research, Kingdom of Saudi Arabia³, Sharī'ah Board of Kuwait Finance House⁴, Sharī'ah Board of Dubai Islāmic Bank⁵, Sharī'ah Supervisory Board of Islāmic Bank of Sudan⁶, and a large number of renowned religious scholars like Sheikh Abdul Aziz bin Baz, Shaik Salih Fouzan, Allamah

¹ See, Resolution of *Fiqh* Academy, World Muslim League, Makkah, 1995, Resolution No.4, Session No. 14.

² See, Resolutions and Recommendations of International *Fiqh* Academy, Resolution 401, Session No. 7, pp.135-140.

³ *Fatwā* Council of KSA, *Fatwā* No. 7468, vol 13 p. 408.

⁴ Sharī'ah Ruling on Economic Matters, Kuwait Finance House, *Fatwā* No. 532.

⁵ Sharī'ah Rulings, Sharī'ah Supervisory Board of Dubai Islāmic Bank, *Fatwā* No. 49.

⁶ Sharī'ah Rulings of Sharī'ah Supervisory Board of Islāmic Bank, Sudan, *Fatwā* No. 16.

Yusuf al-Qaradawi, Dr. Ali Salus, Shaikh Abdullah Ibn Bai⁷, etc. hold this view.

These scholars assert that just as an individual is not allowed to invest his capital or property in an impermissible business; in the same way, one is not allowed to subscribe shares of a company which undertakes some forbidden activity. This is a sort of assistance and cooperation in the act of sin, prohibited by the Sharī'ah. A Muslim is required to abstain from *ḥarām* and also which is doubtful as regards its permissibility and impermissibility. The Holy Prophet (pbuh) has said: "*ḥalāl* is clear and *ḥarām* is also clear and between them are certain doubtful things which may people do not recognize. He, who guards himself against doubtful things, keeps religion and honor blameless, but whosoever, indulges in them falls into what is unlawful" ⁸ In one of its Sharī'ah verdicts, *Fiqh Academy of Rabitah al-Alam al-Islāmi* maintained that "It is not lawful for a Muslim to buy shares of companies or banks which partly deal in *ribā*, when the buyer is fully aware of the fact. The reason for its prohibition is that the Qur'ān and Sunnah prohibit dealing in *ribā*, no matter the amount of *ribā* is small or big. To purchase shares of company which deals in *ribā* knowingly, is to take part in *ribā* based activity, because the management of company while lending or borrowing money with interest, in fact acts as an agent of shareholders."⁹

In response to a question posed to the Permanent Committee for Research and *Iftā'* of KSA, about shares of companies which provide public services such as electricity, gas, transport etc, but deposit their surplus money in conventional banks, the Permanent Committee for Academic Research and *Fatwā* ruled:

"It is not permissible to subscribe shares of companies which deposit their surplus amount in interest bearing account, when the purchaser knows about it. It is a kind of cooperation in act of sin and disobedience". ¹⁰ It further provides: "Placement of funds of these companies in conventional banks is impermissible likewise, to be

⁷ These scholars have presented their papers in the seventh session of International *Fiqh Academy* Jeddah. See, *Majallah Majma Fiqh* vol.7 pp-1-415.

⁸ Al-Bayhaqi, *Shu'ab al 'iman*, vol.5, P.50 *hadith* No. 5740.

⁹ See, Resolution No. 4, *Fiqh Academy, Rabitah al-Alam al-Islāmi*, 14th Session held on 1415H/1995 Ad.

¹⁰ See, *Fatwā al-Lajnah al-Dā'imah li al-Bu f'ith al-'Ilmiyyah wa al-Iftā'*, KSA, *Fatwā* No.7468 vol. 13, p408.

shareholder in companies that deal in *ribā*, is unlawful, even if such company was not originally founded for *ribā* activity".¹¹

4. View Point of Proponents

There is yet another group of scholars who allows investment in companies which carry out mixed activities including interest based borrowing and lending. They, however, prescribe certain conditions or rules for such investments. This position is taken by Shaikh Taqi Usmani, Shaikh Muhammad Ibn othaimeen, Shaikh Abdullah Ibn al-Mavi, Dr. Nazih Hammad, and the organizations such as Sharī'ah Boards of Islāmic Bank of Jordan and Meezan Investment Management Ltd. In the following, rules prescribed by this group for investment in mixed business are discussed.

5. Rules for Investment in Mixed Business

The conditions and rules prescribed by them pertain to interest-based borrowing, placement of funds with conventional banks, quality of unlawful income, etc.

5.1 Rule No. 1

Borrowing with interest should not exceed prescribed limits. There is a difference of opinion regarding the permissible limit. Position of different Islāmic capital market indices providers on the issue is as follows:

- a) Dow Jones position on the issue is that interest bearing debt should not exceed 33% of total market capitalization of company.
- b) AAOIFI's position on the indebtedness of company is that it should not exceed 30% of total market capitalization.¹²
- c) Meezan Index allows interest bearing debt up to 37% of total assets.¹³

5.2 Rule No. 2

Investment in non-Sharī'ah compliant activities, such as interest based lending and placement of funds with conventional banks, should not exceed certain limit.

The permissible ratio or tolerance benchmark ranges from 15% to 33% of total assets of the company. 15% benchmark was previously prescribed by the Sharī'ah Board of *Rajhi* Company but subsequently it was totally

¹¹ Ibid, *Fatwā* No. 8715, p.409

¹² AAOIFI, Standard No.21, Clause 3/4.

¹³ See; www.almeezangroup.com/KnowledgeCentre/Shari'ahScreeningCriteria/tabid/124/Default.aspx visited on 22nd March 2015

cancelled. Dow Jones index does not acknowledge any unlawful investment up to 30% of total assets of company whereas Meezan Index sets acceptability limit for the ratio of interest bearing investment at 33% of market capitalization.¹⁴

5.2.1 Shari'ah Advisory Council (SAC) of the Securities Commission Malaysia (SC) Position on Mixed Activity

For companies with activities comprising both permissible and non-permissible elements, the SAC considers two additional criteria:

- a) The public perception or image of the company must be good; and
- b) The core activities of the company are important and considered *ma'la fah* to the Muslim *ummah* and the country, and the non-permissible element is very small and involves matters such '*umūm balwa*'¹⁵ (common plight and difficult to avoid), '*urf*'¹⁶ (custom) and the rights of the non-Muslim community' which are accepted by Islām.

5.2.2 Benchmarks of Tolerance

The Shari'ah scholars at Shari'ah Advisory Council Malaysia have suggested following benchmarks of tolerance of mixed business:

a) Five-Percent Benchmark

This is applied to assess the level of mixed contributions from the activities that are clearly prohibited such as *ribā* (interest-based companies like conventional banks), gambling, liquor and pork.

b) Ten-Percent Benchmark

This is applied to assess the level of mixed contributions from the activities that involve the element of '*umūm balwa*' which is a prohibited element affecting most people and difficult to avoid. For example, interest income from fixed deposits in conventional banks.

c) Twenty Five-Percent Benchmark

This benchmark is used to assess the level of mixed contributions from the activities that are generally permissible according to Shari'ah and have an

¹⁴ http://www.sc.com.my/wp-content/uploads/eng/html/icm/Resolutions_SAC_2ndedition.pdf

¹⁵ '*Umūm balwa*' is a situation or action that affects most people and is difficult to avoid. Things are said to be the nature of '*Umūm balwa*' when they affect the members of the society in general. They are matters of which people generally have definite needs that afflict people in general and recur relatively frequently in people's life. [al-Mausu'ah al-fiqhiyah al-Kuwaitiyah, 1st Ed (Dar Al Safwa: 1994), , vol.31, p.6.

¹⁶ '*Urf*' (العرف) is an Arabic Islāmic term referring to the custom of a given society. To be recognized in an Islāmic society if compatible with the Shari'ah law.

element of *maṣlaḥah* (public interest), but there are other elements that may affect the Sharī'ah status of these activities. For example, hotel and resort operations, shares trading etc., as these activities may also involve other activities that are deemed non-permissible according to the Sharī'ah.

5.3 Rule No. 3

Earning from impermissible investments/activities should not exceed 5% of total revenue. As mentioned earlier, this criterion applies to the companies whose core business is Sharī'ah compliant such as hotels which may also serve alcoholic drinks as a part of their main activity. In addition to that, they maintain account with conventional banks which fetches the company some interest. The company may also at times deploy excess short term liquidity in bank deposits and securities as a measure of treasury management. Such investments are allowed by the Sharī'ah scholars and Islāmic capital market indices providers, as long as the income from impermissible business activities and investments is less than or up to 5% of total revenue of company. But the shareholder is required to cleanse the actual percentage of impermissible income from his dividend income.

These bench marks of tolerance may be summarized in the form of table as follows:

Table 1: General Bench Mark of Tolerance

Islāmic Indices Providers	Debt to total Assets ratio	Liquid to total Assts ratio	Account receivables to total Assets ratio	Impermissible Income
Dow Jones	Less than 33%	Less than 33%	Less than 45%	Less than or Equal to 5% of Total Revenue
FTSE	Less than 33%	Less than 33%	Less than 50%	Less than or Equal to 5% of Total Revenue
Meezan Islāmic Fund Index	Less than 33%	Less than 25%	Less than 75%	Less than 5% of Total Revenue
SEC Malaysia	Less than 33%	Less than 33%	N/A	5% - 25% of Total Revenue depending on nature of activities

6. Arguments of the Proponents of Mixed Activity

The scholars allowing mixed activity and mixed investments, rely on general - evidences of Sharī'ah, such as the principle of *hājjah* (need), *rafa' al-haraj* (removal of hardship) and similar evidences. No specific evidence is adduced to prove validity of stocks of mixed companies. These scholars, for instance, argue that Sharī'ah acknowledges relaxation of rules in case of necessity and need. In Sharī'ah, sometimes a public need is treated like necessity that calls for relaxation of rules. On this basis, *bai' al-wafā'*¹⁷ (sale with right of redemption) has been allowed by later Hanafi jurists.

The argument of these scholars is that a company has become a need of day. A company provides opportunity to investors to investment their surplus money. But it is also a fact that modern companies frequently resort to interest bearing borrowings to meet their liquidity needs. The companies also place their excess funds with conventional banks. This is true that it is not Islāmically desirable to deal with such companies. But to ignore them totally may cause a greater harm for the individuals and society. According to a known Sharī'ah principle a lesser harm is endured to avert a greater harm.¹⁸ Another Sharī'ah principle suggests that when two interests clash, one weak and other strong, latter prevails.¹⁹ They also argue that borrowing with interest is not lawful but the borrower becomes lawful owner of the amount that he has borrowed. He can lawfully trade with it. The profit generated from it is also *halāl*.²⁰

In the opinion of these scholars, *ribā* occurring in the stocks of these companies, forms only a subsidiary part of stock which is composed of tangible assets, cash and interest bearing debt.

7. Screens for Acceptable Financial Ratios

As a general rule of Sharī'ah, a share can be traded at par only if it represents only cash. But if it has been converted to some illiquid assets, then it can be traded at value different from its face value. The opinions of Sharī'ah scholars and Islāmī Capital market indices providers are divided on acceptable limit of liquid assets, and the liquidity thresholds suggested

¹⁷ *Bai' al-Wafā'* is defined as an archaic sale with redemption (See: Mansoori, Muhammad Tahir, 2011, P.344).

¹⁸ Al-Zarqa, Ahmed, Reviewed by Abdu Aattar Abu Ghuddah, (Damascus: Dar Al-Qalam, 2nd Edition), P.199-200.

¹⁹ Al-Saeedan, Waleed bin Rashid, "*Talqeeh al-afham al-ilmiyah bi-sharh al-Qawa'id al-Fiqhiyyah*", vol.4, P.10.

²⁰ Usmāni, M. Taqi, "Islām aur Jadid Maeshat wa Tijarat", p.87.

by the Sharī'ah Boards range from 33% to 75% of total assets of company. Liquid assets include account receivables as well.

Following are some important screening criteria regarding acceptable liquidity ratios.

- 1) According to Meezan, for a company to be Sharī'ah compliant, the total illiquid assets of the investee company, should be at least 25% of the total assets.
- 2) According to Dow Jones, liquid assets should be less than 33% of market capitalization.
- 3) AAOIFI sets acceptable limit of liquid assets at 30% of total assets.

7.1 Sharī'ah Basis of Acceptable Financial Ratios

The main reliance of Sharī'ah scholars is on the juristic principle that provides: "A matter that cannot be ignored in independent contracts can be ignored in subsidiary contracts" (*yajūzo taba'n mā lā yajūzo istiqlālan*)²¹, and the principle: "A thing which is not permissible in itself, may be permissible as accessory".²² From these juristic principles and maxims they conclude that rules of *ribā al-fadl* and *sarf* will be relaxed in cases where *ribā* does not occur in principal part of transaction. Thus, when the assets of company are composed of tangible assets, cash and debt, the rules of *sarf* will not be applied because the primary object of transaction is trading in tangible assets of the Company, not an exchange between two *rabwi* (*ribā* bearing) commodities. So size of cash and debt will be ignored, because cash and debts have subsidiary status in the contract. The AAOIFI also upholds this position, although its own view point about acceptable ratio of liquid asset is 30% of total assets. This implies that the scholars at AAOIFI require that illiquid assets should constitute a significant part of combination. Section 3/19 of Sharī'ah standard No.21 lays emphasis on primary object of transaction. It states:

²¹ Ibn Rajab, Zain Uddin Aburrehman bin ahmed bin Rajab al-Baghdadi al-Hanbali, Al-Qawa'id al-Fiqhiyah, commentary: Dr. M. Ali Al-banna, (Beirut, 1st Edition), P.363.

²²Art. 54, Majallah al-Ahkam al-Adliyyah, Commentary: Najib Hawaywini, Karkhana Tijarat e Kitab, Karachi; Afandi, Ali Haider Khwaja Ameen, Dur ul Hukam fi Sharh Majalah al Ahkam, Transliteration by: Fahmi Al-Hussaini, (Dar Al-Jalil: 1st Edition, 1991), P.55-56; Sayuti, Jalaluddin, Al-Ashbah Wa-Alnazair FiQawaid Wa Furu Fiqh Al-Shafiiyyah, (the analogues and the similar in the bases and the branches of Shafit jurisprudence) Editor: Hasan Isma'il, Dar Al-kutub Al-Ilmiyah, 1st Edition, 2010, P.184-185.

"If the purpose and activity pertains to trading in tangible assets, benefits and rights, trading in its shares is permitted, without taking into account the rules of *sarf* transaction in debts; irrespective of their size, as in such case these are secondary. If, however, the objective of corporation and its usual activity is dealing in gold, silver or currencies, it is obligatory to undertake trading in its shares in the light of the rules of *sarf*.

The evidential basis of above ruling of AAOIFI is a famous *hadith* of Ibn 'Umar', and a number of Sharī'ah Maxims mentioned in the beginning of discussion. We discuss here *hadith* narrated by Ibn 'Umar and the opinion of Muslim Jurists' on the issue.

7.2 *Hadith of Ibn 'Umar*

It is narrated: by Ibn Umar (ra), that Prophet (pbuh) said: when a person buys a slave who has wealth, then the wealth is for the seller, unless the buyer stipulates this too.²³

In this *hadith*, the word "Wealth": refers to cash, debt and gold. The *hadith* indicates that cash or debts, less or more, will not be taken into account in the *hukm*, because in this case, cash possessed by slave is secondary and subordinate to the primary contract, which is a sale of slave. Thus, sale is affected, primarily on slave not cash or debt; which he possesses. Thus, cash will not be exchanged with similar amount. Ibn Hajar explains the *hadith* in the following words;

"The generality of the words indicates permissibility of sale of slave; in absolute manner. Thus, sale is lawful, even if the wealth held by the slave is a *rabwi* commodity (such as gold and silver): because, the sale transaction is affected on the slave and not on wealth i.e. gold and silver. Wealth in the transaction is subsidiary, which is irrelevant in the contract".²⁴

Imām Mālik has also taken the same position in *al-Muwattā*. He comments on the *hadith*, "It is our considered opinion, that if a buyer stipulated for wealth of slave in the contract, it would be the property of buyer; regardless of whether it is in cash form, or it is receivable, and

²³ *Bukhārī*, with commentary of *Fateh al-Bārī*, (Cairo: Salafi Publishers, 1380AH), vol2, p.81

²⁴ *Fateh al-Bārī*, Al-matba' al-Salafiyah, (Cairo: 1380AH) vol.5, p.51.

regardless of whether the wealth of slave exceeds the price of slave, or is equal to it.²⁵

The statement of Imām Mālik (Allah's Blessing be upon him) is explicit, that *sarf* rules will be ignored in this case, because the gold possessed by the slave, is not the principal object of contract. Such sale is permissible, even if the price paid by the buyer, is also in the form of gold. There is yet another ruling in Mālikī law, which suggests that the value of gold content should not be more than one third of the value of the asset, slave in this case. In a statement in *al-Muwattā*, Imām Mālik rules that:

“if a person bought a sword or ring with gold or silver content against dinars or dirhams as consideration, such sale would be permissible if the value of gold or silver content is one third and the value of remaining part is two third, provided the sale takes place hand to hand, without any delay, in the delivery of counter-values. This is what the people of Madinah have been practicing till our time.”²⁶

Renowned Sharī‘ah scholar Maulana Taqī Usmani also subscribes to this view. He says that the illiquid part of the combination should not be in ignorable quantity. He, however, stipulates that the price of the combination should be more than the value of the liquid amount contained therein. For example, if a share of 100 dollars represents 75 dollars plus some fixed assets, the price of the share must be more than 75 dollars. In this case, if the price of the share is fixed 105, it will mean that 75 dollars are in exchange of 75 dollars owned by the share and the balance of 30 dollars is in exchange of the fixed assets. Conversely, if the price of that share is fixed as 70 dollars, it will not be allowed because the 75 dollars are represented by the share in this case, against an amount which is less than 75. This kind of exchange falls within the definition of *ribā*, and is not allowed.²⁷

7.3 Some Other Classical Opinions

- 1) The Hanafī and Hanbali jurists allow sale of a dirham and one *mudd* (a measurement) of *‘ajwah* dates with two dirham. In this case, one dirham will be against dirham and other dirham will be counted as

²⁵Malik bin Anas, *Al-Muwattā*,: M. Fuad Abdul Baqi, (Beirut: , Dar Ihya Aturath Al Arabi, 1985), Vo.2, P.775

²⁶ Ibid, Ibn Qasim, a senior pupil of Imām Mālik says: “it’s lawful to buy slave along with money he holds, against dirhams or credit” [Ibn Abdul Barr, vol.19, p.32]

²⁷ Usmani, “*Islām aur Jadid Maeeshat wa Tijarat*”, Idara-e- Ma‘arif ul Qur’ān, (Karachi: 1996), p.86

price of *mudd* 'ajwah. But they do not allow sale of one *mudd* 'ajwah dates and one *dirham*, in exchange of one *dirham* or less than one *dirham*, because in case of its sale at par; or with discount, gives rise to *ribā al-fadl* takes place which is prohibited.²⁸

- 2) Shāfi'ī jurists do not allow exchange between two homogenous *ribā* bearing goods, such as sale of one *mudd* (a measurement of capacity) and *dirham* with two *dirhams*, or sale of sword studded with gold against *dīnārs*²⁹. They rely for their view on the *hadith* of Fadālah Ibn 'Ubaid (ra). It is narrated by Fadālah (ra) that when Prophet (pbuh) was in Khyber a gold necklace studded with the precious stones was brought to him. This necklace, a part of the war booty, was for sale. The Prophet (pbuh) ordered that gold content of the necklace be separated from the rest. Thereafter, the Prophet (pbuh) directed that the gold of the necklace be sold for gold on the basis of equality in weight.³⁰ From this, the Shāfi'ī jurists have concluded that sale of an object composed of illiquid and liquid asset is not allowed, unless the liquid content in it is separated from the rest, and the same is sold on the basis of equality in weight.

8. Analysis of Screens

We have explained above that two sets of Screens that govern modern capital market, first pertains to business of the investee company and second deals with financial ratios.

8.1 Screens for mixed activity

As noted earlier, mixed activity refers to that investee company whose primary business is lawful, but it is involved in some impermissible activity. Impermissible activity, besides other things, also include placing deposit and surplus money of the company in interest bearing accounts as well as carrying interest bearing debts. The scholars allowing mixed

²⁸ *Fat ʿal-Qadīr*, Al-Shaukani, (Beirut: 'Iam al-kutub), vol.6, p.266; Al-Mughni, Abi 'Abdullah Muhammad bin Ahmed bin Muhammad bin Qud' mah al-Maqdisi, (Riyadh: Maktabah Al-Riyadh al 'adīthah), vol.4, p.39; ibn 'Ābidīn, M. Ameen bin Umer bin Abdul Aziz, *Rad Al-Muhtar ala al-dur al-mukhtar* (Hashiat ibn 'Ābidīn), (Beirut: Dar al-fikir, 2nd edition, 1992) vol4, p.236

²⁹ *Rawdah al-ḥalībīn*, Abu Zakariyyah Yahya bin Sharaf Al-Nawawī, (Damascus: Al-Maktabah Al-Islāmiyah lil ḥibā'ah wa a-Nashar), vol.3, p.384-386, Al-Mughni, vol.4, p.39; *Auwn Al-Ma'būd*, vol9, p.201

³⁰ *ḥajj* Muslim, Muslim bin ḥajj Edt: Muhammad Fuad Abdul Bāqī, (1955), *Kitāb Al-Musaqāt*, vol.3 p. 1213-1214, *Sunan A-Tirmizi with commentary of Tuhfat al A ḥwazī* Al-Salami, (Al-I'timad publisher), vol.4, p.465.

activity business, argue that Sharī'ah principles of *rafa' al-haraj* (removal of hardship), *'umūm balwa* provide Sharī'ah jurisdiction for the above activity. These principles call for relaxation in the general rule of prohibition. Malaysian screening criterion tolerates forbidden portion of business even upto 25% invoking the principle of *'umūm balwa*, which in our view, is an out of context use of principle. The principle speaks about a matter of common occurrence, which is though unlawful, but cannot be easily avoided, so relaxation in general rule is sought. It does not refer to a situation where a person deliberately involves himself in an unlawful business and justifies it on the plea that *ḥarām* is so prevalent that it is hard for him to avoid.

To justify interest bearing loans, some scholars also argue that though it is improper and abhorrent act to acquire interest bearing loan, yet the borrower becomes the lawful owner of borrowed amount. The borrowed money in consequence of loan contract moves into risk and liability of the borrower and; because of the risk and liability, he is entitled to profit resulting from it. It is, however, advisable according to these scholars that he should donate in charity that portion of profit which he earned from the investment as interest based loan. In *fiqhi* Symposium of Al-Barkah, *fatwā* No.12, it was held that "If value of share of a company which sometime carried interest bearing borrowing, has risen, due to interest based loan and performance of company, any value addition in the company owing to injection of interest bearing loan/capital should be proportionately donated in charity". Commenting on the *fatwā*, Dr. Abdus Sattar Abu Ghuddah, a renowned scholar of Islāmic finance, held the view that such charity is only a recommended act not obligatory on the investee company. The company, because of the risk and liability in relation to borrowed amount is rightful owner of income arising from its investment. To declare it legitimate income Abu Ghuddah invokes famous Sharī'ah maxim: "*Al-Ghurmu bi al-Ghunm*" i.e. Gain is with risk and liability.³¹ However, the verdict of Dr. Abu Ghudah, may not need any comment. One may easily conclude from it that he is unintentionally advocating the permissibility of interest bearing borrowing.

Similar to it is the opinion that suggests that the shareholder should raise his voice in Annual General Meeting against policy of the management of the investee company for interest based borrowing. After expressing his dissatisfaction, he is absolved of his responsibility towards

³¹ Abu Ghuddah, Dr. Abdul Sattar, "*Al-Ajwibah al- Sharī'ah fī al-Taḥqīq al- Maṭrafīyyah*", Sharikah al-Tawfīq, (Majmū'ah Dallah al-Barkah, 2002), p.140

Allah, and cannot be held responsible for this forbidden act. The scholars holding this opinion do not suggest an investor that he should disinvest his stock, immediately on knowing the fact that company is engaged in interest based borrowing. In our opinion, if he does not disinvest it, he is deemed to be a part of impermissible business of company. Besides, the suggestions to record protest may not be practicable for minority shareholders who hold very small number of shares.

9. Conclusion

From the above discussion we may conclude that the Sharī'ah scholars may now need to review the basis of deciding the tolerance levels for the screens, particularly the relaxation about interest bearing borrowings, or placing surplus money in interest bearing accounts up to certain limits (one third) which is not justified in the light of Islāmic principles. Hence, such relaxation should be excluded from the list of approved *Sharī'ah* Screens keeping in view the severity of prohibition of *ribā*. Needless to say those such screens were devised about two / three decades back when Islāmic financial institutions were very limited in number and did not have capacity to cater the needs of investee companies, which compelled them to resort to conventional banks for interest based borrowing for the development of their business. Today, the Islāmic banks have the potential and capacity to meet the working capital need of companies through *ijārah*, *salam* and *istisnā'*, and thus, need for interest based borrowing does not arise. The same can be said about placement of surplus funds in conventional banks. The opportunity is now available to place funds with Islāmic banks and earn income in Sharī'ah compliant manner. It would not be out of place to mention here that Dr. Husain Hamid Hassan, a renowned scholar of Sharī'ah from Azhar University, also subscribes to this viewpoint. In his paper presented in the 20th symposium of Al-Barakah on Islāmic Economics in Malaysia, he writes: "It is not allowed to take part in the business of a company whose objectives is lawful and permissible, but it raises interest based loans, against interest, or its contracts are irregular or void. The trading of such shares, and profit arising from it, is illegitimate. The reason is that it is a sort of cooperation in an act of sin and disobedience of Allah".³²

As regards the proportion of cash and receivables in the assets of a company, the fact of the matter is that it cannot be treated with that

³² See, Hassan, Hussain Hamid, paper titled: "*Components of Share and Effect Thereof on Trading*" presented in symposium on 3-5 Rabi al-Awwal, 1422 AH, held in Kuala Lumpur.

strictness and rigidity which is required to be observed in cases of interest based borrowing and lending. We should bear in mind that cash and receivables are basically lawful components of company's business. Certain restrictions are, however, required to be observed in trading of companies' shares. But the strict rules of *sarf* and *ribā al- fadl* cannot be applied on shares trading, when they are traded as a subsidiary part of the transaction. *Hadith* of Ibn 'Umer and its explanation by Mālikī jurists and Ibn ʾajar 'Asqalānī, clearly provides that quantum of cash is ignored when the purpose of business is not trading in cash. In *hadith* of Fudalah bin 'Ubaid al-Ansārī, on the other hand, the sale of golden necklace for equivalent dinars was a Sharī'ah requirement because gold was the principle object of sale and it was the principle part of transaction. In other words, sale was affected on gold i.e. necklace. On this analogy, if the primary objective of Investee Company is to trade in currency (Forex exchange business) or gold or silver, or debt instruments, then rules of *sarf* and *ribā al- fadl* will be strictly applied on it. Similarly, if the company has not started its business and its whole capital is in form of cash, or in form of receivables at the time of liquidation, then rules of *bai' al-sarf* and *ribā al- fadl* will be applied on it. Other than these situations, quantum of liquid vis-a-vis illiquid or accounts receivable in total assets of a company doing business and having some real assets will be ignored and rules of *ribā al- fadl* will not be taken into consideration strictly in trading of its shares. However, Sharī'ah board of any bank or fund management company may like to determine any threshold for guidance of their treasuries.

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